

Report of the auditor-general to the North West provincial legislature and the council on the Tlokwe City Council

Report on the financial statements

Introduction

1. I have audited the financial statements of the Tlokwe City Council set out on pages XX to XX, which comprise the statement of financial position as at 30 June 2015, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA standards of GRAP), the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2014 (Act No. 10 of 2014) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.



Opinion

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Tlokwe City Council as at 30 June 2015 and its financial performance and cash flows for the year then ended, in accordance with SA standards of GRAP and the requirements of the MFMA and the DoRA.

Emphasis of matters

7. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unauthorised, irregular and fruitless and wasteful expenditure

8. As disclosed in note 38.1 to the financial statements, unauthorised expenditure of R7 605 676 was incurred in the current year and unauthorised expenditure in respect of prior years of R235 248 036 had not yet been dealt with in accordance with section 32 of the MFMA.
9. As disclosed in note 38.3 to the financial statements, irregular expenditure of R57 537 237 was incurred in the current year and irregular expenditure from prior years of R392 625 450 had not yet been dealt with in accordance with section 32 of the MFMA.
10. As disclosed in note 38.2 to the financial statements, fruitless and wasteful expenditure from prior years of R1 686 288 had not yet been dealt with in accordance with section 32 of the MFMA.

Impairments and material losses

11. As disclosed in notes 29 and 40.12 to the financial statements, impairments of R75 755 608 (2014: R14 702 796) as a result of the significant impairment of debtors and material water and electricity distribution losses of R44 914 527 (2014: R30 225 058) were incurred.

Restatement of corresponding figures

12. As disclosed in note 34 to the financial statements, the corresponding figures for 30 June 2014 have been restated as a result of errors discovered during 30 June 2015 in the financial statements of the Tlokwe City Council at, and for the year ended, 30 June 2014.

Material underspending of the budget

13. As disclosed in note 46 to the financial statements, the municipality has materially underspent the capital budget on various infrastructure capital expenses amounting to R43 116 964. Consequently, service delivery was negatively affected.

Additional matters

14. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unaudited disclosure notes

15. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.



Unaudited supplementary schedules

16. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

Report on other legal and regulatory requirements

17. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected objectives presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

18. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected key performance area presented in the annual performance report of the municipality for the year ended 30 June 2015:
 - Key performance area: Basic service delivery and infrastructure development on pages XX to XX
19. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
20. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned objectives. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's Framework for managing programme performance information (FMPPI).
21. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
22. The material findings in respect of the selected key performance area is as follows:

Key performance area: Basic service delivery and infrastructure development

Usefulness of reported performance information

23. Section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) requires that the integrated development plan (IDP) should form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 27% of the reported objectives, 30% of the reported indicators and 22% of the reported targets in the annual performance report were not consistent with the objectives, indicators and targets as per the approved IDP. This was due to the lack of proper planning and communication between the performance manager and the different departments during the drafting of the IDP and service delivery and budget implementation plan (SDBIP).
24. The FMPPI requires that indicators be well defined and verifiable and targets be specific, measureable and time bound:



- A total of 26% of the targets were not specific.
- The required performance for 26% of the targets could not be measured.
- A total of 41% of the indicators were not well defined.
- A total of 44% of the indicators were not verifiable.

This was because management did not adhere to the requirements of the FMPPPI due to a lack of proper technical indicator descriptions and no proper systems and processes in place.

Reliability of reported performance information

25. The FMPPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. I was unable to obtain the information and explanations I considered necessary to satisfy myself as to the reliability of the reported performance information. This was due to the fact that the auditee could not provide us with sufficient and appropriate audit evidence to substantiate the reported performance because no proper record keeping system regarding performance information was implemented. No suitable alternative audit procedures could be performed to obtain reasonable assurance about the reliability of performance information.

Additional matter

26. I draw attention to the following matter:

Achievement of planned targets

27. Refer to the annual performance report on pages XX to XX for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected key performance area reported in paragraphs 23 to 25 of this report.

Compliance with legislation

28. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance management

29. The local community was not afforded the opportunity to comment on the final draft IDP before adoption, as required by section 42 of the MSA and regulations 9, 13(1), 13(4)(c) and 15(3) of the Municipal planning and performance management regulations (MPPMR).
30. The municipality did not give effect to its IDP and conduct its affairs in a manner which was consistent with its IDP, as required by section 36 of the MSA, section 21(2)(a) of the MFMA and regulation 6 of the MPPMR.
31. The IDP was not reviewed annually and adopted by the council based on the assessment of its performance measurements and changing circumstances, as required by section 34 of the MSA and regulations 3 and 11 of the MPPMR.
32. The performance management system was not in line with the priorities, objectives, indicators and targets contained in its IDP and did not link to the integrated development planning processes as required by section 38(a) of the MSA.



33. Key performance indicators (KPIs), including input, output and outcome indicators, in respect of each of the development priorities and objectives were not set out in the IDP, as required by section 41(1)(a) of the MSA and regulations 1 and 9(1)(a) of the MPPMR.
34. The KPIs set by the municipality did not include indicators on percentage of households with access to basic level of water, sanitation, electricity and solid waste removal as required by section 43(2) of the MSA and regulation 10(a) of the MPPMR.
35. Measurable performance targets for the financial year were not set in the IDP, for each of the KPIs and with regard to the key performance area, as required by section 41(1)(b) of the MSA and regulations 12(1) and 12(2)(e) of the MPPMR.
36. Revisions to the SDBIP were not approved by the council after the approval of the adjustment budget, as required by section 54(1)(c) of the MFMA.

Financial statements, performance and annual reports

37. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements in non-current assets, current assets, liabilities, expenditure and disclosure items identified by the auditors in the submitted financial statement were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.
38. The annual performance report for the year under review did not include reliable measures taken to improve performance as required by section 46(1)(c) of the MSA.

Internal audit

39. The internal audit unit did not function as required by section 165(2) of the MFMA, in that it did not prepare a risk-based audit plan and an internal audit programme for the financial year under review.

Procurement and contract management

40. Awards were made to providers whose principal shareholders are in the service of the municipality in contravention of section 112(j) of the MFMA and SCM regulation 44. Furthermore the provider failed to declare that he/she was in the service of the municipality, as required by SCM regulation 13(c).
41. Awards were made to providers whose principal shareholders are in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulation 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).
42. Persons in the service of the municipality who had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e).
43. Persons in service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e).
44. Contracts were awarded to bidders that did not score the highest points in the evaluation process, as required by section 2(1)(f) of Preferential Procurement Policy Framework Act.

Human resource management and compensation

45. The municipality did not develop and adopt appropriate systems (policies) and procedures to monitor, measure and evaluate performance of staff contrary to of section 67(d) of the MSA.



Expenditure management

46. Reasonable steps were not taken to prevent unauthorised expenditure as well as irregular expenditure, as required by section 62(1)(d) of the MFMA.

Revenue management

47. The indigent policy that forms part of the credit control and debt collection policy was not implemented, as required by section 96(b) of the MSA and section 62(1)(f)(iii) of the MFMA.

Liability management

48. An effective system of internal control for liabilities was not in place, as required by section 63(2)(c) of the MFMA.

Consequence management

49. Unauthorised, irregular as well as fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

Environmental management

50. The municipality operated its wastewater treatment facility without a license in contravention of section 20(b) of the National Environmental Management Waste Act, 2008 (Act No. 59 of 2008) (NEMWA), section 24(2)(a) of the National Environmental Management Act, 1998 (Act No. 107 of 1998) (NEMA) and section 22(1)(b) of the National Water Act, 1998 (Act No. 36 of 1998) (NWA).
51. The municipality's operational activities at its waste disposal sites and wastewater treatment facility contravened or failed to comply with the requirements of its waste management license and the regulatory norms and standards as required by sections 67(1)(f) and (h) of the NEMWA and sections 151(1)(c) and (i) of the NWA.
52. The municipality's waste management and disposal activities contravened or failed to comply with the requirements of section 28(1) of the NEMA, section 19 of the NWA and sections 16(1)(c) and (d) and 26(1)(b) of the NEMWA.
53. The municipality did not exercise its legislative and executive authority as required by section 11(3)(l) and (m) of the MSA by managing, monitoring and enforcing environmental related bylaws to promote a safe and healthy environment.

Internal control

54. I considered internal control relevant to my audit of the financial statements, the annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

55. Sound integrity and ethical values to promote a culture of honesty, with ethical business practices and good governance, protecting and enhancing the best interests of the entity are not understood and implemented in order to set the standard to ensure compliance with laws and regulations.



- 56. Adequate oversight responsibility regarding performance reporting and compliance with laws and regulations is not exercised.
- 57. Effective HR management is not implemented, to ensure that adequate and sufficiently skilled resources are in place and that performance is monitored. An effective organisational structure for placing appropriately skilled people is not in place. There was a lack of continuity in key management positions due to their employment contracts that ended, leading to these positions being filled by acting officials. The additional workload and pressure on the individuals who are acting in these positions had a negative impact on the financial and performance reporting responsibilities and monitoring compliance with laws and regulations.
- 58. Policies and procedures are not adequately implemented to enable and support understanding and execution of internal control objectives, processes, and responsibilities. Furthermore, policies and procedures are not adequately communicated, to ensure that all officials understand the operating thereof and can implement the procedures as required.

Financial and performance management

- 59. The municipality did not implement a proper record keeping system to ensure that complete, relevant and accurate information is accessible and available to support performance reporting and compliance with laws and regulations.
- 60. Management's internal controls and processes over the preparation and presentation of financial statements were not able to ensure that the financials were free from material misstatements. As a result, material corrections had to be made.
- 61. Management failed to design and implement formal controls to review and monitor compliance with applicable laws and regulations and performance reporting.

Governance

- 62. Management do not have an adequate risk strategy that addresses performance reporting and non-compliance with laws and regulations.
- 63. The internal audit department was not effective during the financial year. Council and management failed to recognise the value that internal audit can add to the municipality.
- 64. The audit committee did not provide effective oversight over the internal control environment including financial and performance reporting and compliance with laws and regulations.

Auditor General

Potchefstroom

30 November 2015



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence



